APPENDIX A — SUMMARY ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED AND FILED NOVEMBER 23, 2009

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 09-1445-cv

DEANNA MCBREARTY, MARYLYNN HARTSEL, individually, derivatively, and on behalf of all others similarly situated,

Plaintiffs-Appellants,

-v.-

THE VANGUARD GROUP, INC., GEORGE U. SAUTER, DUANE F. KELLY, JOHN J. BRENNAN, CHARLES D. ELLIS, RAJIV L. GUPTA, AMY GUTMANN, JOANN HEFFERNAN HEISEN, ANDRE F. PEROLD, ALFRED M. RANKIN JR., J. LAWRENCE WILSON, ACADIAN ASSET MANAGEMENT, LLC, RONALD D. FRASHURE, JOHN R. CHISHOLM, BRIAN K. WOLAHAN, MARATHON ASSET MANAGEMENT, LLP and NEIL M. OSTRER,

Defendants-Appellees,

Appendix A

VANGUARD INTERNATIONAL EQUITY INDEX FUNDS, D/B/A VANGUARD EUROPEAN STOCK INDEX FUND, VANGUARD HORIZON FUNDS, D/B/A VANGUARD GLOBAL EQUITY FUND,

Nominal Defendants-Appellees,

ALLIANCE BERNSTEIN LP, HENRY S. D'AURIA, SHARON E. FAY, KEVIN F. SIMMS, WILLIAM J. ARAH and JEREMY H. HOSKING,

Defendants.

November 20, 2009, Decided

PRESENT:

HON. RALPH K. WINTER,
HON. ROSEMARY S. POOLER,
Circuit Judges,
HON. JED S. RAKOFF,
*District Judge.**

SUMMARY ORDER

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the district court is **AFFIRMED.**

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* The Honorable Jed S. Rakoff, United States District Judge for the Southern District of New York, sitting by designation.

Appendix A

Plaintiffs-appellants appeal a judgment entered on April 6, 2009 in the United States District Court for the Southern District of New York (Cote, *J.*) dismissing with prejudice plaintiffs' claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* ("RICO"). Plaintiffs were shareholders in certain of defendants' mutual funds that had invested in online gambling companies. They brought this civil RICO action after the shares of these online gambling companies declined in value following a government crackdown on illegal offshore gambling. We assume general familiarity with the underlying facts, procedural history, and issues on appeal.

We review *de novo* the district court's grant of a motion to dismiss, taking all reasonable inferences in plaintiffs' favor. *City of N.Y. v. Smokes-Spirits.com, Inc.*, 541 F.3d 425, 439 (2d Cir. 2008).

To state a civil RICO claim, plaintiffs must show that they were injured "by reason of" the alleged racketeering activity, 18 U.S.C. § 1964(c), that is, that the defendant's RICO violation proximately caused plaintiffs' injuries. *See Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 457, 126 S. Ct. 1991, 164 L. Ed. 2d 720 (2006); *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 267-68, 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992); *see also Smokes-Spirits*, 541 F.3d at 440-41; *Lerner v. Fleet Bank, N.A.*, 318 F.3d 113, 121-22 (2d Cir. 2003). In the RICO context, proximate causation means, in turn, that "the alleged violation led directly to the plaintiff's injuries." *Anza*, 547 U.S. at 461. Here, however, the

complaint alleges that the decline in the funds' online gambling holdings was not the direct result of the RICO violation —the owning and/or financing of illegal gambling — but rather was the result of the subsequent "government crackdown" on the illegal gambling. Although plaintiffs contend that the law enforcement crackdown was a foreseeable risk of defendants' activities (rather than a supervening cause),[1] we have already held that proximate causation is lacking under RICO when the harm results from the exposure or disclosure of the RICO predicate activity. *In re Am. Express Co. S'holder Litig.*, 39 F.3d 395, 400 (2d Cir. 1994).[2]

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1. Although foreseeability is often the test of proximate causation at common law, *see Palsgraf v. Long Island R.R. Co.*, 248 N.Y. 339, 162 N.E. 99, 100 (N.Y. 1928), RICO causation is a concept distinct from "proximate causation as that term is used at common law." *Abrahams v. Young & Rubicam Inc.*, 79 F.3d 234, 237 (2d Cir. 1996).

2. Although plaintiffs argue that *American Express* is undercut by the Supreme Court's recent decision in *Bridge v. Phoenix Bond & Indemnity Co.*, 128 S. Ct. 2131, 170 L. Ed. 2d 1012 (2008), we do not agree. The civil RICO action in *Bridge* was brought by regular bidders at a county's auctions of tax liens, who alleged that the defendants, also regular bidders, were able to obtain a disproportionate share of valuable liens by lying to the county about their status as "related entities" in order to circumvent a rule that would otherwise result in a more equitable distribution of liens. *Id* at 2135-36. Thus, the injury alleged in *Bridge* — the plaintiffs' inability to obtain valuable liens to which they would otherwise have been entitled — resulted directly from the fraudulent representations that constituted the racketeering activity.

Plaintiffs also argue that the "underlying premises" of the proximate cause requirement set forth by the Supreme Court in *Holmes v. Securities Investor Protection Corp.*, 503 U.S. at 269-70, support a finding of proximate cause here.[3] It is hardly clear that this is so; but even assuming *arguendo* that these policy considerations cut in plaintiffs' favor, they cannot remedy the basic defects in causation discussed above, nor provide a basis for overruling our clear prior precedents.

For the foregoing reasons, the judgment of the district court is hereby **AFFIRMED**.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

BY: Frank Perez

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3. These considerations are: "(1) the factual difficulty of measuring indirect damages and distinguishing among distinct independent causal factors; (2) the complexity of apportioning damages among plaintiffs 'to obviate the risk of multiple recoveries'; and (3) the fact that 'the need to grapple with these problems is simply unjustified by the general interest in deterring injurious conduct, since directly injured victims can generally be counted on to vindicate the law.'" *Smokes-Spirits*, 541 F.3d at 440 (quoting *Holmes*, 503 U.S. at 269).

APPENDIX B — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED AND FILED APRIL 2, 2009

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

08 Civ. 7650 (DLC)

DEANNA McBREARTY and MARYLYNN HARTSEL, individually, derivatively and on behalf of all others similarly situated,

Plaintiffs,

-v-

THE VANGUARD GROUP, INC.; GEORGE U. SAUTER; DUANE F. KELLY; JOHN J. BRENNAN; CHARLES D. ELLIS; RAJIV L. GUPTA; AMY GUTMANN; JOANN HEFFERNAN HEISEN; ANDRE F. PEROLD; ALFRED M. RANKIN, JR.; J. LAWRENCE WILSON; ACADIAN ASSET MANAGEMENT, LLC; RONALD D. FRASHURE; JOHN R. CHISHOLM; BRIAN K. WOLAHAN;; ALLIANCEBERNSTEIN LP; HENRY S. D'AURIA; SHARON E. FAY; KEVIN F. SIMMS; MARATHON ASSET MANAGEMENT LLP; WILLIAM J. ARAH; JEREMY H. HOSKING; and NEIL M. OSTRER,

Defendants,

-and-

Appendix B

VANGUARD INTERNATIONAL EQUITY INDEX FUNDS, d/b/a VANGUARD EUROPEAN STOCK INDEX FUND; and VANGUARD HORIZON FUNDS, d/b/a VANGUARD GLOBAL EQUITY FUND,

Nominal Defendants.

April 2, 2009, Decided
April 2, 2009, Filed

DENISE COTE, District Judge:

This lawsuit concerns an investment fund's liability to its shareholders for investments in online gambling companies. The investments declined in value after the gambling companies became the targets of a United States government crackdown. Plaintiffs, each a shareholder in one of the nominal defendants, bring this derivative and putative class action lawsuit alleging violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 ("RICO"), as well as state-law claims for breach of fiduciary duty, negligence and waste. Defendants have moved to dismiss the complaint arguing that, *inter alia*, plaintiffs lack statutory standing under RICO because they cannot show that they were injured "by reason of" the defendants' alleged RICO violations. Plaintiffs having been injured by the government's enforcement actions and their attendant publicity, and only indirectly (at best) by the defendants' purchase of stock, their RICO claims are dismissed for failure to plead proximate causation.

Appendix B

BACKGROUND

The following facts are taken from the complaint. Plaintiff Deanna McBrearty purchased shares in nominal defendant Vanguard European Stock Index Fund ("Vanguard European") on or about May 20, 2005. Plaintiff Marylynn Hartsel purchased shares in nominal defendant Vanguard Global Equity Fund ("Vanguard Global") sometime prior to July 1, 2006.[1] Plaintiffs allege that the nominal defendants repeatedly purchased shares in "illegal gambling businesses," as defined by 18 U.S.C. § 1955. In or about 2006, federal and state law enforcement agencies "began a crackdown" on gambling businesses, such as those in which the nominal defendants had invested. Consequently, the stock prices of the gambling business owned by the nominal defendants dropped precipitously, and plaintiffs' portfolios declined in value. The plaintiffs name as defendants the investment advisor and the portfolio managers responsible for investment decisions made by the nominal defendants and individuals associated with each of these entities.

Plaintiffs allege that, by purchasing and holding stock in the gambling businesses subject to the government's enforcement activities, the defendants conspired together to commit predicate acts under RICO by "finane[ing]" or "own[ing]" an illegal gambling business, in violation of 18 U.S.C. § 1955. Their

1. Vanguard European and Vanguard Global will be referred to collectively as the "nominal defendants."

investments in gambling businesses over a multi-year period, plaintiffs assert, constitute a pattern of racketeering activity that injured plantiffs "as a direct and proximate result."

This action was filed on August 29, 2008. On October 27, 2008, the defendants moved to dismiss the complaint. Plaintiffs' opposition, filed on November 24, asserted that their complaint was sufficient to withstand defendants' motions, but requested leave to amend in the alternative.

At a December 18 conference, the parties agreed with the Court's proposal to initially address two of the issues raised in the motions to dismiss — whether plaintiffs had demonstrated that defendants' alleged RICO violations caused their injuries, thereby conferring standing to sue under RICO, and the sufficiency of the purchase of gambling-company stock as a predicate act under RICO. A finding in the defendants' favor on either issue, the parties agreed, could not be cured by amendment. Were the plaintiffs to prevail on both issues, they would then have the opportunity to amend their complaint to cure any possible deficiencies, and then the remainder of defendants' motions to dismiss would be considered. As explained below, it is only necessary to reach the first of these two issues to conclude that the RICO claim must be dismissed.

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DISCUSSION

A trial court considering a Rule 12(b)(6) motion must "accept as true all factual statements alleged in the complaint and draw all reasonable inferences in favor of the non-moving party." *McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 191 (2d Cir. 2007). At the same time, "conclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to defeat a motion to dismiss." *Achtman v. Kirby, McInerney & Squire, LLP*, 464 F.3d 328, 337 (2d Cir. 2006) (citation omitted). A court considering a Rule 12(b)(6) motion applies a "flexible plausibility standard, which obliges a pleader to amplify a claim with some factual allegations in those contexts where such amplification is needed to render the claim plausible." *Boykin v. KeyCorp*, 521 F.3d 202, 213 (2d Cir. 2008) (citation omitted). "To survive dismissal, the plaintiff must provide the grounds upon which his claim rests through factual allegations sufficient to raise a right to relief above the speculative level." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007).

Defendants assert that plaintiffs cannot plausibly allege a violation of RICO, because they cannot plead that defendants' alleged violations of RICO proximately caused plaintiffs' injuries. RICO's civil provision, 18 U.S.C. § 1964(c), provides a private cause of action for any person injured in her business or property "by reason of" a violation of RICO. *McLaughlin v. American Tobacco Co.*, 522 F.3d 215, 222 (2d Cir. 2008) (citing 18 U.S.C. § 1964(c)). In *Holmes v. Securities*

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Investor Protection Corporation, 503 U.S. 258, 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992), the Supreme Court refined its earlier conception of causation (the "by reason of" requirement) and explicitly imposed a proximate causation requirement for civil RICO actions. Three policy considerations informed its decision to limit the plaintiffs who could recover from a RICO violation to those who were directly or proximately injured:

> (1) the factual difficulty of measuring indirect damages and distinguishing among distinct independent causal factors;
>
> (2) the complexity of apportioning damages among plaintiffs to obviate the risk of multiple recoveries; and
>
> (3) the fact that the need to grapple with these problems is simply unjustified by the general interest in deterring injurious conduct, since directly injured victims can generally be counted on to vindicate the law.

Smokes-Spirits.Com, Inc., 541 F.3d at 440 (citing *Holmes*, 503 U.S. at 269). Thus, "[t]o fulfill the requirement that the injury occur 'by reason of a defendant's action, a plaintiff must show that the defendant's violation not only was a 'but for' cause of his injury, but was the proximate cause as well." *McLaughlin*, 522 F.3d at 222 (citation omitted).

Proximate causation, or loss causation, does not exist where the plaintiff's injury was "indirectly (and hence not proximately) caused by the racketeering activity." *Baisch v. Gallina*, 346 F.3d 366, 373 (2d Cir. 2003). *See also Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 460, 126 S. Ct. 1991, 164 L. Ed. 2d 720 (2006) (proximate cause requires a "direct causal connection" between the RICO violations and the injury suffered). Injuries that are "too attenuated" from the RICO predicate acts are too remote to satisfy the proximate cause requirement. *City of New York v. Smokes-Spirits.Com, Inc.*, 541 F.3d 425, 440 n.20 (2d Cir. 2008). Proximate cause is thus lacking where the cause of the asserted harms is "a set of actions . . . entirely distinct from the alleged RICO violation." *Id.* at 441 (citation omitted). "[W]hen factors other than the defendant's [misconduct] are an intervening direct cause of a plaintiff's injury, that same injury cannot be said to have occurred by reason of the defendant's actions." *McLaughlin*, 522 F.3d at 226 (citation omitted). Injuries occurring because of the disclosure of a scheme involving the predicate acts, rather than because of the predicate acts themselves, are not the "necessary result" of the predicate acts, and do not give rise to RICO standing. *In re Am. Express Co. Shareholder Litig.*, 39 F.3d 395, 400 (2d Cir. 1994) (citation omitted). *See also Abrahams v. Young & Rubicam Inc.*, 79 F.3d 234, 239 (2d Cir. 1996).

Put otherwise, a defendant accused of violating RICO is potentially liable only "to those with respect to whom his acts were a substantial factor in the sequence of responsible causation, and whose injury was

reasonably foreseeable or anticipated as a natural consequence." *Baisch*, 346 F.3d at 373-74 (citation omitted). Those whose injuries are "reasonably foreseeable or anticipated as a natural consequence" generally include "the targets, competitors, and intended victims of the racketeering enterprise." *Lerner v. Fleet Bank, N.A.*, 318 F.3d 113, 124 (2d Cir. 2003).[2]

Proximate causation is lacking here because the shareholders were injured not by the ownership of or investment in the illegal gambling operations, but by the reaction of the stock price to the publicity following the government's investigation of those operations. "[T]he commission of the RICO violations was not what injured" plaintiffs; as they acknowledge, "it was the exposure of those acts," through the government's investigation, as illegal that "caused the [plaintiffs'] harm." *American Express*, 39 F.3d at 400. The direct cause of plaintiffs' injuries is therefore a "set of actions [the government crackdown] entirely distinct from the alleged RICO violation [conducting an illegal gambling operation]." *Smokes-Spirits*, 541 F.3d at 441 (citation omitted). An injury created by the disclosure of a scheme or, similarly, by intervening actions (the government investigation), does not give rise to RICO standing. *American Express*, 39 F.3d at 400.

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2. The relationship between the zone of interests analysis and more recent formulations of proximate cause is discussed in *Smokes-Spirits*, 541 F.3d at 440 n.20.

Further, as in *American Express*, "the shareholders . . . were certainly not the intended targets of the RICO violations," but were the intended beneficiaries of the investments in the gambling funds. *Id.* Plaintiffs' protestations that proximate causation does not require that their injury be the "preconceived purpose" or "specifically intended consequence" of the predicate acts does not displace the forseeability requirement, which under *Lerner* is generally limited to injuries incurred by "targets, competitors, and intended victims" of the RICO violations. *Lerner*, 318 F.3d at 124.

Plaintiffs have raised no plausible claim that they are a member of any of these groups. Those who lost money by gambling online, or competitors offering legal gambling services are the ones who may be able to argue that they are the reasonably foreseeable intended victims, competitors, or targets of illegal gambling operations. Indeed, cases from this Circuit and elsewhere, when discussing victims of gambling enterprises, refer to those who gambled and lost, and not to investors in the enterprise. *See, e.g.*, *Price v. Pinnacle Brands, Inc.*, 138 F.3d 602, 607 (5th Cir. 1998); *United States v. Joseph*, 835 F.2d 1149, 1152 (6th Cir. 1987); *United States v. Littman*, 421 F.2d 981, 982 (2d Cir. 1970). Plaintiffs, as those providing economic backing for the gambling investments, were not the intended victims or targets of this enterprise.

Plaintiffs rely instead on the three policy considerations identified in *Holmes* and subsequently cited by the Second Circuit in *Smokes-Spirits*, which underlie the adoption of the proximate cause test. *Holmes*, 503 U.S. at 269; *Smokes-Spirits*, 541 F.3d at 440. They attempt to argue that they

are the parties best situated to bring RICO claims to recover on the shareholders' behalf. Plaintiffs argument misses the point; the *Holmes* factors support but do not alter the analysis of proximate causation discussed above. Because intervening events, and not the defendants' investment decisions, proximately caused the plaintiffs' investment losses, plaintiffs' RICO claims must be dismissed for lack of causation.

CONCLUSION

Plaintiffs' RICO claims are dismissed with prejudice. As there are no longer any federal claims against the defendants in this suit, it is within the Court's discretion whether to exercise supplemental jurisdiction over plaintiffs' state law claims. *Klein & Co. Futures, Inc. v. Board of Trade of City of New York*, 464 F.3d 255, 263 (2d Cir. 2006). Since this action has not yet proceeded to the merits of plaintiffs' claims, this Court declines to exercise supplemental jurisdiction. The Clerk of Court shall enter judgment for the defendants on the RICO claim and dismiss the remaining claims without prejudice to refiling in state court.

SO ORDERED:

Dated: New York, New York
April 2, 2009

s/ Denise Cote
DENISE COTE
United States District Judge

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING DATED AND FILED JANUARY 12, 2010

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, 500 Pearl Street, in the City of New York, on the 12th day of January, two thousand ten.

No. 09-1445-cv

DEANNA MCBREARTY, MARYLYNN HARTSEL, individually, derivatively, and on behalf of all others similarly situated,

Plaintiffs-Appellants,

-v.-

THE VANGUARD GROUP, INC., GEORGE U. SAUTER, DUANE F. KELLY, JOHN J. BRENNAN, CHARLES D. ELLIS, RAJIV L. GUPTA, AMY GUTMANN, JOANN HEFFERNAN HEISEN, ANDRE F. PEROLD, ALFRED M. RANKIN JR., J. LAWRENCE WILSON, ACADIAN ASSET MANAGEMENT, LLC, RONALD D. FRASHURE, JOHN R. CHISHOLM, BRIAN K. WOLAHAN, MARATHON ASSET MANAGEMENT, LLP and NEIL M. OSTRER,

Defendants-Appellees,

Appendix C

VANGUARD INTERNATIONAL EQUITY INDEX FUNDS, D/B/A VANGUARD EUROPEAN STOCK INDEX FUND, VANGUARD HORIZON FUNDS, D/B/A VANGUARD GLOBAL EQUITY FUND,

Nominal Defendants-Appellees,

ALLIANCE BERNSTEIN LP, HENRY S. D'AURIA, SHARON E. FAY, KEVIN F. SIMMS, WILLIAM J. ARAN and JEREMY H. HOSKING,

Defendants.

Deanna McBrearty and Marylynn Hansel having filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*, and the panel that determined the appeal having considered the request for panel rehearing, and the active members of the Court having considered the request for rehearing *en banc*,

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

By: s/ Frank Perez
Frank Perez, Deputy Clerk